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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

ALCAN ALUMINIUM LIMITED,
Petitioner,

v.

THE FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, Operating Through Its New York Office; FRANK GOODMAN, Individually, and As District Manager, New York Office of the Franchise Tax Board of the State of California; and JOSEPH E. GOEGHEGAN, Individually, and As Supervisor-Audit Group, New York Office of the Franchise Tax Board of the State of California,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF OF THE GOVERNMENT OF THE UNITED KINGDOM AS AMICUS CURIAE SUPPORTING CERTIORARI

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INTEREST OF AMICUS CURIAE

This case presents important questions of interpretation concerning the Foreign Commerce Clause of the United States Constitution, which provides that "Congress shall have Power . . . To regulate Commerce with foreign Nations . . . ."[1] The decision below holds in

[1] Art. I., § 8, cl. 3.

effect that the application by a State of the United States of a "unitary" method of taxation to the combined worldwide incomes of a domestic subsidiary and its foreign parent does not violate the Foreign Commerce Clause, even though the unitary method conflicts with the "arm's length" method used by the United States government and the international community generally.

The decision below imposes a significant burden on U.K. companies engaged (through subsidiaries or otherwise) in trade or other gainful pursuit in the United States. Businesses headquartered in the United Kingdom account for more than $23 billion in foreign direct investment in the United States, more than any other nation.[2] Because of the extensive U.K. investment in the United States, the participation by U.K. corporations in business activities involving both the United States and third countries, and the adverse impact that the decision below will have on those activities, the Government of the United Kingdom has a significant interest in the disposition of this petition for certiorari.

SUMMARY OF ARGUMENT

This case, on the merits, presents an issue of great international concern. That issue is whether a State of the United States may, consistently with the Constitution of the United States, apply a unitary method of income taxation to the aggregate worldwide incomes of a foreign parent company, its U.S. subsidiary and all of its foreign subsidiaries for purposes of determining the domestic subsidiary's State tax liability.[3] Attempts by Cal-

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[2] Bureau of Economic Analysis, United States Department of Commerce, *Foreign Direct Investment in the United States in 1982*, 63 Survey of Current Business 31, 36 (Aug. 1983, No. 8).

[3] As the district court found below, under California's unitary taxation scheme, the separate identities of corporate family members are disregarded and consolidated for purposes of determining the net income of that business. Once this figure is ascertained,

ifornia and an increasing number of other States to impose varying versions of such unitary taxation on foreign corporations have provoked protests to the Government of the United States by foreign governments—including the Government of the United Kingdom, which has been emphatic in expressing its views on this issue.[4]

Last Term, the Court expressly reserved decision on the constitutionality of this practice when it decided *Container Corp of America v. Franchise Tax Board*.[5] That case involved the separate issue of the constitutionality of California's unitary taxation of a U.S. parent company and its foreign subsidiaries.[6] California's attempt to reach to the worldwide income of a *foreign* parent company and its foreign subsidiaries raises different and more difficult constitutional questions than the practice sustained in *Container Corporation*. Those questions go to the very heart of the foreign commercial relationships between the United States and its trading partners—the regulation of which lies squarely and exclusively with the Congress under the U.S. Constitution.[7]

The courts below ruled that Alcan (which they characterized as a mere shareholder of its wholly owned U.S. subsidiary Alcancorp) lacked standing to challenge the constitutionality of California's application of the unitary tax method to the incomes of Alcan and its nearly

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the percentages of the business entity's sales, property and payroll within California are averaged. The previously determined net income is then multiplied by the average percentage to arrive at the corporation's tax liability. Petition App. II at A5.

[4] Container Corporation of America v. Franchise Tax Board, 103 S. Ct. 2933, 2960 n.4 (1983) (Powell, J., dissenting).

[5] 103 S. Ct. 2933 (1983).

[6] 103 S. Ct. at 2952 n.26, 2956 n.32.

[7] Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824).

100 non-U.S. subsidiaries operating worldwide.[8] The district court came to that conclusion on the grounds that the unitary tax applied by the Respondents does not result in multiple taxation of Alcan's foreign income nor result in any burden upon foreign commerce.[9] The court of appeals adopted the district court's opinion as its own.

The Government of the United Kingdom submits that the decision below will have a decided and deleterious effect on global trade and investment. That decision flatly contradicts the principles enunciated by the Court in *Japan Line, Ltd. v. County of Los Angeles*,[10] and *Container Corporation* in that: (1) the unitary tax scheme sanctioned therein is incompatible with universally recognized principles of income allocation for tax purposes and inevitably leads to multiple taxation of income of U.K. and other foreign companies, who are also subject to taxation by the foreign countries of their commercial domicile; (2) the decision below vitiates the ability of the United States to speak with "one voice" in matters of foreign commerce and, by opening the door to other States to continue to adopt similarly unitary taxation schemes, invites speaking with a cacophony of voices; (3) the decision below approves a significant State-created disincentive to companies from U.K. and other countries to invest in the United States, thereby imposing a constitutionally proscribed burden on foreign commerce; and (4) the decision below results in a significant and growing burden upon the foreign parent and foreign subsidiaries of multinational corporations which must com-

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[8] The Government of the United Kingdom finds it anomalous that while the worldwide income of Alcan is held eligible for taxation by States of the United States, the parent corporation—a member of the income group which is effectively the subject of taxation—is deemed ineligible to seek review of that taxation method by the courts of the United States.

[9] *See* Pet. App. II at A7-A8, A10.

[10] 441 U.S. 434 (1979).

pile and submit in varying formats to the States of the United States sensitive financial data on the corporations' extraterritorial activities, thereby further impermissibly burdening foreign commerce.

ARGUMENT

A recurring issue before this Court in recent years has centered upon the increasing efforts by States of the United States to bring the income earned by affiliated overseas companies into the tax base to which a State apportionment formula is then applied. Last Term, in *Container Corporation of America v. Franchise Tax Board*, the Court held that the Constitution does not forbid a State to apply unitary taxation to reach the income earned by the foreign subsidiaries of a U.S. parent company.[11]

However, the Court expressly reserved decision on the constitutionality of application of the unitary method where the parent company is *foreign*.[12] Three dissenting Justices stated that an application of unitary taxation to United States activities of a foreign corporation would violate the Constitution.[13]

This case involves a foreign parent, and therefore squarely presents that issue.

The district court purported to base its holding on a finding that Alcan lacked standing and said that it would not reach the merits of Alcan's complaint. However, the district court supported its holding on standing by finding that California had only taxed what it was entitled to tax—a holding on the merits.[14] The court of ap-

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[11] 103 S. Ct. 2933 (1983).

[12] 103 S. Ct. at 2952 n.26, 2956 n.32.

[13] 103 S. Ct. at 2960 (Powell, J. joined by Burger, C.J., and O'Connor, J., dissenting).

[14] Pet. App. II at A7-A8.

peals adopted the opinion of the district court, and affirmed.

If the decision below stands, it portends significant consequences for the foreign commerce of the United States and its commercial relations with the United Kingdom and its other trading partners.

I. The Application Of California's Unitary Scheme To Foreign Corporations Results In Multiple Taxation And Prevents The United States From Speaking With "One Voice" In Regulating Foreign Commerce

A State tax is unconstitutional under the Foreign Commerce Clause if it either (1) "creates a substantial risk of international multiple taxation" or (2) prevents the federal government from "speaking with once voice when regulating commercial relations with foreign governments." *Japan Line, Ltd. v. United States.*[15] The application of California's unitary tax scheme to a foreign parent company and its non-U.S. subsidiaries violates each of these constitutional provisions.

A. *Utilization of a Unitary Tax on U.S. Operations of Foreign Corporations Is Inconsistent With Universally Recognized Principles of Income Allocation and Makes Multiple Taxation Inevitable*

At issue here is the clash of two incompatible and irreconcilable methods of income allocation for tax purposes. One method is the "arm's length" approach, which, as the Court noted in *Container Corporation*, is the universally accepted method adopted by the international community (including the United Kingdom and the United States government) of income allocation for taxation of related corporations.[16] Under the arm's length approach, every corporation, even if closely tied to other corpora-

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[15] 441 U.S. at 451.

[16] 103 S. Ct. at 2950.

tions, is treated for most purposes as if it were an inadependent entity dealing at arm's length with its affiliated corporations, and is subject to tax only by the jurisdictions in which it operates and only for the income it realizes on its own books.[17] The other method is the "unitary business/formula apportionment" method adopted by California and a number of the other States of the United States.[18] This system rejects geographical or transactional accounting, treats as one the separate entities—foreign and domestic—that are comprised by an enterprise, and apportions the aggregate income between the taxing jurisdiction and the rest of the world on the basis of a formula.[19] As the Court noted in *Container Corporation*, California has adopted a taxing system that represents a "serious divergence" from the internationally accepted taxing method adopted by foreign taxing authorities and preferred by the United States government.[20] The unitary system is at odds with the model conventions for the avoidance of multiple taxation adopted by the United Nations and the Organization for Economic Corporation and Development (OECD), and principles adopted by the world community in double taxation treaties.[21]

The ramifications of California's using a different system are significant. Most large corporations have profitable as well as less profitable (and some unprofitable) activities. Under the arm's length system, the profitable

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[17] *Id.*

[18] 103 S. Ct. at 2940.

[19] *Id.*

[20] 103 S. Ct. at 2952.

[21] *See* United Nations Model Double Taxation Convention Between Developed and Developing Countries, arts. 7(2), 9(1), U.N. Doc. ST/ESA/102 (1980); Report of the OECD Comm. on Fiscal Affairs, Model Convention for the Avoidance of Double Taxation With Respect to Taxes on Income and on Capital, arts. 7(2), 9(1) (1977); *see, e.g.*, U.S. Treasury Department's Model Draft Income Tax Treaty of June 16, 1981, arts. 7(2), 9(1), 1 CCH Tax Treaties ¶ 158.

activities pay taxes where the profits are made, and the less profitable or unprofitable ones pay less or no taxes in the jurisdictions where they exist. The unitary method of income allocation, however, assumes that the entire enterprise (the "unit") has the same level of profitability throughout the enterprise; the amount of taxation in a particular jurisdiction is based on a formula considering only the proportion of property, payroll and sales in that jurisdiction.[22]

In *Container Corporation*, the Court cautioned that if California's method of formula apportionment "inevitably" led to double taxation, it would be constitutionally suspect.[23]

However, the Court determined that California need not abandon its apportionment formula method in favor of the arm's length method because double taxation was not inevitable under the former method, and was also possible under the latter method. The Court concluded that it would not "require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation."[24] The Court seems to have suggested that double taxation under either system would be more or less random and would occur with equal frequency. This suggestion is incorrect.

First. Double taxation or undertaxation engendered by California's apportionment scheme is not merely incidental; it is inevitable because the fundamental assumptions underlying the California scheme allocate income to a given jurisdiction in proportion to the wage rates, property values and sales prices in that jurisdiction (rather than upon the income actually earned in that jurisdiction as calculated by the arm's length method).

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[22] 103 S. Ct. at 2943.

[23] 103 S. Ct. at 2954.

[24] 103 S. Ct. at 2954-55.

Thus, if a corporation earns income in non-U.S. jurisdictions whose wage rates, property values and sales prices are lower than the corresponding rates, values and prices in California,[25] California *systematically* allocates only a proportion of that foreign income to the foreign jurisdiction where it is earned, thereby subjecting the unallocated portion to State tax in California notwithstanding the fact that such income has been taxed by the host country under internationally accepted principles of taxation. The petitioner Alcan's experience provides a vivid illustration of the unavoidable double taxation trap created by California's apportionment scheme.

As Alcan demonstrated below, in years when its U.S. operations were unprofitable and its foreign operations showed profits, it nonetheless paid California income tax.[26] Since Alcan's U.S. operations had no net income to tax, the "income" upon which the California tax was based could only have been obtained by California through the allocation of Alcan's foreign income to California pursuant to the California apportionment formula. However, pursuant to accepted international practice, all of this income was also taxed previously in the country of origin. Thus, Alcan's experience in California points up the double taxation of foreign companies inherent in the allocation method, and leaves no doubt that this result is neither a random occurrence, nor a matter of mathe-

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[25] This is not an infrequent occurrence. In his report to Congress, the Comptroller General noted that although there have been no definitive studies measuring differences in the values of apportionment factors between the United States and foreign countries, "available evidence from independent researchers does indicate that property values and wages, even after adjustments for productivity differences, may be substantially lower in many foreign countries than in the United States." Report by the Comptroller General to the House Comm. on Ways and Means: Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving 37 (GAO/GGD-82-38 (1982)).

[26] Pet. App. III at 17.

matical imprecision, but is rather an inevitable consequence of the application of the unitary scheme.

The only conceivable way whereby the California apportionment formula would not result in double taxation would be if the income allocated to California pursuant to the apportionment formula were *identical* to the income actually earned by the corporation in California. This is at best a very rare event, and the realities are to the contrary as evidenced by the widespread international concerns voiced by the United States' trading partners with respect to the perpetuation (and likely proliferation) of the unitary method.

In *Japan Line*, this Court declared that "[e]ven a slight overlapping of tax" upon foreign commerce warrants close scrutiny.[27] Such scrutiny is clearly warranted here.

Second. It is true that differences in the allocation of income and expenses among national tax jurisdictions employing the arm's length method can also result in double taxation or undertaxation. This effect can be produced by varying accounting systems, exchange rates, and other similar causes. However, these differences, being those of inconsistent application of the same principle, can be eliminated and are susceptible to resolution through international negotiation and bilateral and multinational tax treaties.

By contrast, the inherent double taxation arising out of the apportionment method occurs because that method has an entirely different principle for deciding where income is earned. This difference is irreconcilable. Only in the rare instance where the very different assumptions underlying both systems yield the same result are they consistent with each other.

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[27] 441 U.S. at 456.

B. *Utilization of a Unitary Tax by the States Of the United States Prevents the United States From Speaking With "One Voice" in Regulating Foreign Commerce*

It is a well-recognized and longstanding doctrine of constitutional law that "[i]n international relations and with respect to foreign intercourse and trade the people of the United States act through a single government with unified and adequate national power." *Board of Trustees v. United States*, 289 U.S. 48, 59 (1933). In *Japan Line*, the Court recognized that a State tax on foreign commerce may frustrate the achievement of federal uniformity, and held that such a tax is unconstitutional if it prevents the Federal Government from speaking with "one voice" in international trade.[28] The Court noted that a state tax would frustrate federal uniformity if it created an "asymmetry" in the international tax structure, or if other States followed the taxing State's example, thereby subjecting foreign commerce to "varying degrees of multiple taxation."[29] In *Container Corporation*, the Court concluded that the California income tax (unlike the California property tax in *Japan Line*) did not violate the Foreign Commerce Clause because: (i) it did not create an "*automatic* asymmetry" in the international tax structure; (ii) the tax fell upon a *domestic* parent company; and (iii) the issue was therefore one of local rather than international concern in that foreign nations had no significant interest in reducing the tax burden of a domestic U.S. corporation.[30]

The present case involves the specific concerns raised by the Court with respect to the California tax in *Japan Line*, and contains none of the distinguishing factors enumerated by the Court in upholding the application of

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[28] 441 U.S. at 451.

[29] 441 U.S. at 450-51.

[30] 103 S. Ct. at 2955-56.

the California tax to United States corporations in *Container Corporation*. Indeed, this case is the very case on which the Court reserved decision in *Container Corporation*.

Moreover, if the apportionment scheme stands, it opens the door for other States to impose analogous schemes, thereby creating a myriad of multiple taxation formats, which in turn would result in the United States speaking with many voices in the realm of foreign commerce.

In *Japan Line*, the Court, in holding a California tax unconstitutional under the Foreign Commerce Clause, declared: "California, by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." [31]

Here, California, by its unilateral act, has established an income allocation and taxation scheme at variance with the international system. This State-created regulation of international earnings is a compelling reason for review by this Court.

II. Utilization Of The Unitary Tax Approach Imposes A Significant Burden On U.K. And Other Foreign Corporations

The unitary apportionment method used by California and other States to allocate income to U.S. offices or subsidiaries of U.K. companies imposes significant administrative burdens on doing business in those States. Under the unitary method, the profit of a foreign company on its U.S. business is derived from a formula taking account of the income of the foreign company and its worldwide subsidiaries as well as the assets, payroll and sales of all such companies. For a U.K. multinational company with many subsidiaries in different countries, the submission

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[31] 441 U.S. at 453.

of financial data for all of these companies to a State of the United States imposes a costly burden. The additional administrative burden results from the need to determine whether foreign corporations should be included in the unitary business group, adjusting foreign financial statements to reflect State income tax laws, and translating foreign currency into U.S. dollars.[32] This burden is extreme in the case of widespread multinational corporations because accounting procedures, language and currencies vary significantly from one foreign country to another. Data may have to be obtained from hundreds of subsidiaries operating in numerous foreign countries, which require a "foreign currency translation" to achieve compatibility with U.S. dollars, a procedure the Comptroller General has characterized as "a laborious task." [33]

The costs of compliance are compounded by the need to prepare separate returns that conform to the varying State tax accounting requirements of the States presently employing some variant of the California scheme. As the Comptroller General has noted, corporate taxpayers must treat the income tax returns for each State separately, and a multijurisdictional taxpayer would have to make "still more calculations for every other area where non-uniformity exists . . . ." [34] This problem will only grow if the decision below stands, and additional States adopt the unitary method.[35]

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[32] *See* Report by the Comptroller General to the House Comm. on Ways and Means, Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving 37 (GAO/GGD-82-38 (1982)).

[33] *Id.* at 38-39.

[34] *Id.* at 17.

[35] Prior to the Court's decision in *Container Corporation*, ten States applied unitary taxation on a worldwide basis. Following

Although this burden falls particularly heavily on U.K. corporations because of their extensive U.S. investments, the problem, like the reach of the unitary system, is global.

Underlying all of this is the element of requiring foreign corporations to disclose detailed, highly sensitive information regarding their worldwide operations in order to comply with the accounting requirements of a State of the United States. Moreover, the imposition of a unitary tax—which results in double taxation—has a decided chilling effect on the framework established by the United States and its partners to provide mutual protection for investments.[36]

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the *Container Corporation* decision, Florida adopted a similar system. According to one Florida legislator, "[i]t was like finding money on the street . . . ." *Florida's Legislature Is Latest to Approve Unitary Tax Law*, Wall St. J., July 19, 1983, at 29, col. 1.

[36] Many businesses have stated that they have elected not to locate in California, and others have considered withdrawing because of the unitary tax. *State Taxation of Interstate Commerce and Worldwide Corporate Income: Hearing Before the Subcomm. on Taxation and Debt Management Generally of the Senate Comm. on Finance*, 96th Cong., 2d Sess. 60, 68-71 (1980). This is illustrated by the recent statement of the vice president of the Sony Corporation of America, which commenced operations in California in 1972 prior to California's adoption of the unitary tax:

> "We were very anxious to make things in America. We had to train people, and they had to master new machines, so productivity is low at the beginning. It was expensive and we lost money, but we did it. Then a few years later the tax people came and said we had so much payroll and property in California that we must pay more tax.
>
> "I said, 'Don't you tax people where they make money?' They said, 'I'm sorry, Mr. Wada, but we tax where you have property and payroll.' I don't understand this."

Unitary Tax Scope Widens, N.Y. Times, Oct. 18, 1983, at D2, Col. 1.

CONCLUSION

For these reasons, the Government of the United Kingdom respectfully submits that this Court should grant the writ of certiorari.

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